(15)

No. 91-1513

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

UNITED STATES DEPARTMENT OF THE TREASURY AND MITCHELL A. LEVINE, ASSISTANT COMMISSIONER,

Petitioners,

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE, STATE OF OHIO,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

BRIEF FOR STEPHEN F. SELCKE, DIRECTOR OF INSURANCE, STATE OF ILLINOIS, AS STATUTORY AND COURT-APPOINTED RECEIVER, *AMICUS CURIAE* SUPPORTING RESPONDENT

PETER G. GALLANIS
Counsel of Record
Chief General Counsel to the Director, as Receiver
Office of the Special Deputy Receiver
222 Merchandise Mart Plaza
Suite 1450
Chicago, Illinois 60654
(312) 836-9500

Counsel for Amicus Curiae

Midwest Law Printing Co., Chicago 60611, (312) 321-0220

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INTEREST OF THE *AMICUS CURIAE*

Stephen F. Selcke, the Director of Insurance of the State of Illinois, is obliged by statute to serve as receiver of troubled insurance companies operating within the State (in such capacity the "Receiver"). Ill. Rev. Stat. ch. 73,

¶¶ 799-833 (1991).[1] Illinois is the state of domicile of 448 insurance companies, the largest number in the country behind Arizona, Texas, and New York.[2] Currently, the Director serves as the receiver of a total of 42 companies; of that number, the Director is the receiver of 38 domestic companies, and the "ancillary" receiver of 4 foreign companies.

The interest of the *amicus curiae* in this case appears from a brief review of his obligations under Illinois law, and the conflict that would follow, were Petitioners to prevail in their interpretation of the federal superpriority statute, 31 U.S.C. §3713 (hereinafter the "FPS").

The Director is assisted in the performance of his duties by a special deputy receiver, and by various legal, financial, and insurance professionals who work under the direction of the Director, in his capacity as Receiver. Ill. Rev. Stat. ch 73, ¶ 814. The Receiver is formally appointed by Illinois courts upon the filing of a complaint by the State Attorney General, demonstrating the existence of one or more statutorily enumerated grounds for receivership. *Id.* ¶¶ 800, 800.1. Receivership is a last resort after less drastic means have failed to resolve the affected company's problems. *See, e.g., id.* ¶¶ 646, 789.1. In that sense, receivership is at the end of a continuum of State insurance regulation aimed at protecting the interests of policy owners and beneficiaries.

[1] When acting as statutory receiver, the Director is not a state officer. *People ex rel. Knight v. O'Brien*, 240 N.E.2d 686 (Ill. 1968). When acting as regulator, however, the Director is the state officer primarily responsible for executing the Illinois laws and regulations affecting the business of insurance.

[2] National Association of Insurance Commissioners, *Insurance Department Resources Report* 33 (1990).

As regulator, the Director and his staff monitor the activities of insurers operating in the State. Assuring company solvency—that is, the financial ability to satisfy policy obligations—is a principal objective of that regulatory scrutiny. The Director insures solvency by, *inter alia*, imposing minimum capitalization requirements, *id.* ¶ 655; requiring foreign insurers to secure their obligations by depositing specified securities, *id.* ¶ 723(f)(3); mandating that letters of credit or other collateral be posted to assure the performance of "non-admitted" reinsurers, *id.* ¶ 785.1; and requiring the prudent investment of insurers' funds, *id.* ¶¶ 736-737.24a.

The Director's solvency-related regulatory activities are inextricably linked with his role as Receiver. Monitoring insurers' compliance with solvency standards not only safeguards the ability of operating companies to fulfill their policy obligations; violation of those requirements is a basis for seeking the appointment of a receiver. *See, e.g., id.* ¶ 800. The threat of receivership is one of the most effective sanctions by which the Director can enforce compliance with regulatory requirements. Indeed, receivership is the ultimate regulatory sanction. *See, e.g., Chicago Life Ins. Co. v. Needles*, 113 U.S. 574 (1881). In the event that the Director is appointed Receiver, his statutory charge is dictated by the nature of the receivership.[3] As

[3] Illinois, for example, provides three stages of insurance receivership: conservation, rehabilitation, and liquidation. In conservation, the receiver takes possession of an insurer's assets, business and affairs to conserve them for the benefit of creditors. Ill. Rev. Stat. ch. 73, ¶ 800.1. Rehabilitation vests title to the company's assets in the receiver. *Id.* ¶ 804(2). Its purpose is the "preservation, whenever possible, of the business of an insurance company threatened with insolvency." *People ex rel. Schacht v. Main Ins. Co.*, 448 N.E. 2d 950, 952 (Ill. App. Ct. 1983). Liquidation precludes the transaction of further business by the company and results in a final distribution of its assets. Ill. Rev. Stat. ch. 73, ¶¶ 805, 806; *see generally id.* ¶¶ 799-833.

liquidator, the Receiver must marshal the company's assets and distribute them to policyholders and other claimants in the estate. Ill. Rev. Stat. ch. 73, ¶¶ 805, 817. Here, the Director's prior efforts (as regulator) to ensure company solvency generally maximize the assets available to meet the company's obligations.

Once a company is placed in receivership, it continues to function as an insurance company under the direction of the Receiver, in virtually all respects save the writing of new insurance policies.[4] In particular, the Receiver is responsible for satisfying the company's policy obligations, subject to asset availability. Like an operating company, the Receiver reviews claims, determining their validity and amount; he maintains reserves for ultimate distribution; and he distributes assets *pro rata* to those with valid claims.

A number of the estates for which the Receiver is responsible involve pending or potential claims arguably subject to FPS. For example, in the estate of Heritage Insurance Company of Illinois, in Liquidation, various federal agencies (including, *inter alia*, the Immigration and Naturalization Service and the Small Business Administration ("SBA")) have filed a total of 171 federal claims in respect of immigration bonds, SBA guaranty bonds, performance bonds, and bail bonds in the aggregate amount of approximately $332,000. Similarly, the Internal Revenue Service

[4] A company in conservation operates almost identically to a similar company outside receivership; in some rare instances, the company may even write new business. *See, e.g.* Ill. Rev. Stat. ch. 73, ¶ 646. Likewise, a company in rehabilitation may be virtually indistinguishable from a company outside receivership that is in "run-off"—a voluntary winding-up process in which the company ceases to write new policies and pays claims as they come due from reserves and other available funds.

("IRS") has asserted tax claims against other estates. For example, an IRS claim is now pending against Health Plan of Central Illinois, in Liquidation (a health maintenance organization) in the amount of over $2 million—greater than the total current assets of the estate. In addition, a number of property and casualty companies controlled by the Receiver involve pending or potential federal environmental claims. For example, Centaur Insurance Company, in Rehabilitation ("Centaur"), is defending such claims filed against policyholders by the Environmental Protection Agency, the National Oceanic and Atmospheric Administration, and other agencies. Although the estate's exposure in respect of those claims cannot be estimated at this time, the costs to date of legal defense alone are approximately $4 million. More significantly, the Receiver anticipates that Centaur (like many companies in receivership that wrote comprehensive general liability, products liability, and "umbrella" policies) may be subject to many other federal environmental claims before the estate is closed.

Pursuant to Rule 37.2 of the Rules of this Court, the Receiver respectfully submits this brief as *amicus curiae* in support of Respondent. The Receiver has reviewed and adopted Respondent's arguments; in addition, the Receiver has a substantial interest in the outcome of this case and can provide a unique perspective on the significant issues presented. The Receiver believes that this brief will assist the Court in analyzing and resolving those issues. The parties have consented to the filing of this brief, and their written consents have been filed with the Clerk of the Court.

SUMMARY OF ARGUMENT

Until 1944, the American legal system operated on the assumption that insurance was not "interstate commerce" and therefore beyond the power of Congress to legislate under the Interstate Commerce Clause of the Constitution. U.S. Const. art. I, § 8 cl. 3. That assumption followed from the Court's holding in the case of *Paul v. Virginia*, 75 U.S. (8 Wall) 168 (1868). The issue in *Paul* was whether Virginia restrictions on the powers of foreign insurers were invalid because Congress, and not the states, had the power under the United States Constitution to ". . . regulate commerce . . . among the several States." This Court resolved the issue by holding that the issuance of a policy of insurance was not a transaction of interstate commerce, but rather in the nature of a personal contract, entered into locally, and governed by the local law. *Id.* at 183. This decision, together with the narrow view of congressional power under the Commerce Clause that obtained until the New Deal (*see generally* Laurence Tribe, *American Constitutional Law* at 403-13 (2d ed., 1988)), encouraged the continuing development of comprehensive state regulation of insurance companies.

Paul remained the law until *United States v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944). That case involved the applicability of the price-fixing and monopolization prohibitions of the Sherman Act to members of an insurance trade association. The Court rejected the contention based on *Paul* that Congress had no authority under the Interstate Commerce Clause to enact legislation affecting insurers. The Court concluded that the holding of *Paul* (that the Commerce Clause does not *prohibit* state insurance regulation) did not compel the conclusion that the Commerce Clause does not *authorize* federal legislation having an impact upon insurance. Under

the "stream of commerce" analysis that had recently been approved by this Court, *see, e.g., Wickard v. Fillburn*, 317 U.S. Ill (1937), the Court held that insurance is an enterprise conducting its activities across state lines, and therefore not beyond Congress' commerce power.

Even before the decision was rendered, concern grew in the states, the insurance industry, and Congress about the continued viability of state insurance regulation in the event that the Court ruled (as it did) in favor of the United States. Charles D. Weller, *The McCarran-Ferguson Act's Antitrust Exemption from Insurance: Language, History and Policy*, 1978 Duke L.J. 587, 592. Congress attempted to resolve those uncertainties by passing the McCarran-Ferguson Act, 15 U.S.C. §§1011-1015 ("McCarran").

The issue before this Court has divided the federal Circuit Courts of Appeal: whether the FPS applies to state insurance receiverships, notwithstanding Section 2(b) of McCarran.[5] The Receiver submits that the Petitioners' reading of FPS would virtually prevent him (and similarly situated receivers in other states) from performing the duties imposed upon him by state law. These duties are expected of state insurance receivers and were well known to Congress, both before and after *South-Eastern Underwriters* and the enactment of McCarran. Under the proper analysis, state insurance receivership priority statutes like the one at issue are clearly within the "business of insurance" for purposes of Section 2(b) of McCarran, and therefore are not affected by FPS.

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[5] *See Idaho ex rel. Soward v. United States*, 858 F.2d 445 (9th Cir. 1988), *cert. denied*, 490 U.S. 1065 (1989) (FPS applies to state insurance receiverships); *Gordon v. United States Dept. of the Treasury*: 668 F. Supp. 483 (D. Md. 1987), 846 F.2d 272 (4th Cir. 1988), *cert. denied*, 488 U.S. 954 (1988) (same); *Fabe v. United States Dep't of the Treasury*, 939 F.2d 341 (6th Cir. 1991), *cert. granted*, 112 S.Ct. 1934 (1992).

ARGUMENT

THE POLICY OF STATE REGULATION OF INSURANCE PRECLUDES APPLICATION OF THE FEDERAL PRIORITY STATUTE TO INSURANCE RECEIVERSHIPS

A. PETITIONERS' INTERPRETATION OF THE "BUSINESS OF INSURANCE" WOULD WREAK HAVOC ON THE LONG-STANDING, FEDERALLY APPROVED SYSTEM OF STATE REGULATION AND RECEIVERSHIP OF INSURANCE COMPANIES.

In adopting McCarran, Congress reaffirmed its long-standing conclusion that states are responsible for the regulation and receivership of insurance companies. Petitioners' attempt to impose the restrictions of FPS on state receivers would seriously impair receivers in the performance of their statutory obligations, for the sake of an economic benefit to federal revenues far outweighed by the negative consequences to the intended beneficiaries of state insurance laws.

1. State Law Requires Receivers to Protect Policy Rights.

The primary obligation of a receiver in an insurance liquidation is the payment of claims to insureds and beneficiaries in accordance with the terms of their insurance policies. *See, e.g.*, Ill. Rev. Stat. ch. 73, ¶ 805.

Unlike federal bankruptcy proceedings, insurance receivership laws generally accord to policy claimants priority over other types of claimants in the estate.[6] Such

[6] *See* Davis Howard, *Uncle Sam Versus the Insurance Commissioners: A Multi-Level Approach to Defining the "Business of Insurance" Under the McCarran-Ferguson Act*, 25 Willamette L. Rev. 1, 10-14 (1989).

priority treatment is often justified on the grounds that policyholders frequently are unsophisticated consumers without negotiating leverage, who have little recourse but to accept contracts of adhesion from their insurers; whereas commercial creditors, who are usually accorded a lower distribution priority, have more information and bargaining power. Spencer Kimball, *History and Development of the Law of State Insurer Insolvency Proceedings: An Overview in Law and Practice of Insurance Company Insolvency* 33 (David M. Spector, ed. 1986).[7]

Consequently, typical state insolvency statutes require receivers to devote their primary and continuing attention to the rights of policyholders and the obligations of the subject company under the policies written by the

[7] Petitioners contend that the Ohio priority scheme (like that of Illinois, *cf. Ill. Rev. Stat.* ch. 73, ¶ 817) ranks two classes of claims (administrative expenses and modest wage claims of company employees) ahead of those of policyholders, thereby undermining the Court of Appeals' conclusion that the statute focused on policyholders protection. Brief for Petitioners at 21. Petitioners' contention is unavailing for two reasons.

First, the costs of marshaling assets in the estate must be provided if policyholders and lower priority claimants are to receive distributions, and these costs often include the need to retain the services of employees who worked for the insurer before receivership. This need prompted many courts to permit payment of administrative costs ahead of federal claims in cases where the FPS was held to apply. *See* Howard, *supra* note 6 at 2 n.4.

Second, and more generally, the fact that the statute indicates how residual assets are to be distributed *after* policyholder claims have been paid does not mean that the statute does not focus on the protection of policyholders. Clearly the residuum must go somewhere, and there is no more logical place in the statutes to indicate where the residuum goes than the clauses following those affording priority to policyholders. The simple point is that the policyholder is protected first.

company.[8] This Court has described such an emphasis—on the terms of the company's policy, its interpretation, and enforcement—as the "core" of the "business of insurance." *SEC v. National Securities, Inc.*, 393 U.S. 453, 460 (1969).

2. Application of FPS to Insurance Receiverships Would Drastically Interfere with Receivers' Duties Under State Laws.

Where applicable, FPS provides that claims of the United States must be paid before all other claims, 31 U.S.C. § 3713(a); and that a representative of the estate (*e.g.*, a receiver) is personally liable for the unpaid portion of any federal claim if he has paid other claims or expenses first. *Id.* § 3713(b). If these provisions applied to state receiverships, several drastic consequences would follow.

First, receivers could not satisfy their statutory obligations. In a liquidation, the goal is to marshal and distribute assets to holders of adjudicated claims as quickly as possible. Under Petitioners' analysis, the Receiver would be reluctant to liquidate estate assets to satisfy policy obligations or pay administrative expenses, since any resulting "shortfall" could be the basis for personal liability in the event of a subsequently asserted federal claim. In the case of a failed life or health insurer, this means that benefits for which policyholders and their beneficiaries paid, and on which they relied to avoid financial ruin, are deferred, if not eliminated altogether. Most states guard against such possibilities by making life and health insurance "non-cancellable," and by empowering the liquidator to contract with another company to assume the failed insurer's outstanding policy obligations. *See, e.g.*, Ill. Rev. Stat. ch. 73, ¶¶ 805(4), 1065.80-8. Because insurance policies have a predetermined life span and need immediate attention to be kept alive, the liquidator needs unfettered use of estate assets to set reserves or transfer them to an assuming reinsurer. This Court's decision in *Chicago Life Ins. Co. v. Needles*, 113 U.S. 574 (1885), makes clear that such statutory protection is part of an insurance policy from the time it is issued. Petitioners, however, would sanction a liquidator for using estate assets to protect holders of non-cancellable policies, if the remaining assets were insufficient to cover federal non-insurance claims. This places the liquidator in a no-win situation.

[8] Much of the Receiver's attention is also devoted to matters that are inextricably related to the contractual relationship between the insurer and the insured; *e.g.*, maintaining and investing claim reserves; collection of related reinsurance; and the disposition of litigation involving the policy relationship.

Similar considerations apply to insurance rehabilitation proceedings. In most states the rehabilitator's charge is to remove the causes and conditions which made rehabilitation necessary. *See, e.g.*, National Association of Insurance Commissioners Insurers Rehabilitation and Liquidation Model Act ("NAIC Model Act") § 16(c); Ill. Rev. Stat. ch. 73, ¶ 804(1). Like a bankruptcy reorganization, insurance rehabilitation is a flexible procedure, designed for adaptation to the circumstances presented. However, like a liquidation proceeding, it may be premised on a finding of insolvency and always is begun with the entry of a court order of receivership. *See, e.g.*, NAIC Model Act § 17; Ill. Rev. Stat. ch. 73, ¶ 800 (1991). Technically, therefore, the FPS would be triggered in a rehabilitation. As a result, the rehabilitator cannot take immediate steps to save the company because any such steps may subject him to liability.

One of the Receiver's estates, American Mutual Reinsurance Company, in Rehabilitation ("AMRECO"), presents a case in point. AMRECO is a property/casualty reinsurer that was placed into rehabilitation in 1988. AMRECO pays claims four times a year; monies received from its own reinsurers fund the rehabilitation. The benefits of rehabilitation in this $340 million estate are undeniable: the solvency of AMRECO's own reinsureds is preserved, as is AMRECO's position as a tax-paying member of the community. *See generally In Re: American Mut. Reins. Co.*, No. 1-90-3384, slip op. (Ill. App. Ct. June 26, 1992); Debra J. Anderson, Stephen W. Schwab, Carolyn S. Reed, David E. Mendelsohn, *AMRECO: A Step Towards International Rehabilitations*, 7 J. Ins. Reg. 388 (1989). None of these steps could be taken as long as the threat of a potential, but as yet unasserted, federal claim remains. Petitioners blindly assume that liquidation is the only type of insurance receivership at stake in this case. Contrary to Petitioners' suggestion, rehabilitation does not entail a termination of the company's existence, but rather is dependent on its continued operation in "the business of insurance." *See* Brief for Petitioner at 8. Petitioners thus fail to appreciate that acceptance of their argument would do far greater damage to the insurance industry as a whole than would rejection of their position.

In addition, the Receiver would have no reliable way of knowing at any point whether a federal claim was likely to be asserted in the estate.[9] Consequently, the Receiver would not be able to determine whether funds were available to pursue activities designed to enhance or marshal assets. It should be obvious that uncertainty about the availability of funds to pay administrative expenses may cause a receiver to abandon at least some efforts to marshal into the estate assets that rightfully belong to the company.[10] This uncertainty ultimately redounds to Petitioners' detriment, since the estate then well may be without sufficient assets even to pay federal government claims. *A fortiorari*, if federal claims go unpaid, so do policyholders who need distributions of estate assets to stay in business; pay a decedent's pre-death obligations and funeral expenses; or cover the often catastrophic medical expenses of a disabling injury or disease. In the end, state insurance guaranty funds must absorb these costs, assessing their members for the loss before the members pass their costs on to policyholders in the form of increased premium charges, or to taxpayers, in the form of increased premium tax credits.[11]

Moreover, the threat of personal liability for "mistakes" in reserving for unknown and essentially unknowable federal claims likely would deter qualified people from serving as receivers or members of the receiver's staff. People buy insurance because they are risk averse. Similarly, few business people enter commercial ventures without some appreciation for the level and amount of risk they are undertaking. The size and frequency of certain federal claims (*e.g.*, environmental) present to a receiver an un-

[9] The United States has argued successfully that, under FPS, it is not required to file formal claims in accordance with estate claim-filing deadlines. *See, e.g., United States v. Summerlin*, 310 U.S. 414 (1940); *United States v. Oklahoma*, 261 U.S. 253 (1923).

[10] Examples of such activities include claims against corporate directors and officers for breach of fiduciary obligations; actions to recover assets fraudulently transferred or the subject of voidable preference laws; or arbitration to collect disputed reinsurance recoveries.

[11] *See generally* Howard, *supra* note 6, at 14-18.

justifiable risk—at least one that few competent receivers would undertake in many instances.

Finally, payment of federal claims before all others may deprive estates of the very assets that were made available principally to pay policyholders in the event a company became financially impaired. As noted above, Illinois (like most states) requires that insurers post deposits of specified assets to insure payment of their policy obligations. These "special deposits" are designated by statute for this purpose and are intended not to be used for any other.

The role of the states in dealing with the problems of impaired insurance companies has a long and generally successful history, and that history was well known to Congress when the McCarran-Ferguson Act became law. *See generally* Kimball, *supra*; *see also Prudential Ins. Co. v. Benjamin*, 328 U.S. 408 (1946). The earliest state receivership statute was enacted by New York in 1828. *See* Rev. Stat. of N.Y., ch. XVIII, tit. II (1835). The relative success of the states in this area compares favorably with the efforts of the federal government in certain fields,[12]

[12] *See, e.g.*, Justice Jackson's dissent in *South-Eastern Underwriters*, quoting a 1905 speech by Louis Brandeis:

> Doubtless the insurance departments of some States are subjects for just criticism. In many of the States the department is inefficient, in some doubtless corrupt. But is there anything in our experience of Federal supervision of other departments of business which should lead us to assume that it will be freer from grounds of criticism or on the whole more efficient than the best insurance department of any of the States? For it must be remembered that an efficient supervision by the department of any State will in effect protect all the policyholders of the company wherever they may reside. Let us remember rather the ineffectiveness for eighteen long years of the Interstate Commerce Commission to deal with railroad

(Footnote continued on following page)

at least in part because of the diligence and creativity with which state regulators and receivers have exercised the functions that were reserved to them under the McCarran.

Petitioners now proffer to this Court a construction of FPS that would prevent the states from performing effectively the comprehensive consumer protection role they have assumed at Congress' behest. In particular, Petitioners argue unconvincingly that some aspects of state policyholder protection can be ignored, while others must be respected. Brief for Petitioners at 15 n.5. To the contrary, the efforts of state regulators and receivers to ensure company solvency (*e.g.*, licensing standards *Ill. Rev. Stat.* ch. 73, ¶¶ 720-25; regulation of invested assets *id.* ¶¶ 736-737.24a;, monitoring financial performance *id.* ¶¶ 748, 751;, enforcement of statutory reserving requirements *id.* ¶¶ 853-65, and receivership proceedings, *id.* ¶¶ 799-833) comprise a seamless web of consumer protection from which one strand cannot be pulled without seriously damaging the entire pattern. Indeed, the Court held in 1885 that insurance receivership laws are a statutorily implied term of every insurance company's charter. *Needles*, 113 U.S. at 584. Moreover, the Court specifically held that "[e]very creditor must be presumed to understand "that an insurance company and its contracts are

[12] *continued*

> abuses, the futile investigation by Commissioner Garfield of the Beef Trust, and the unfinished investigation into the affairs of the Oil Trust in which he has since been engaged. Federal supervision would serve only to centralize still further the power of our Government and to increase still further the powers of the corporation.

322 U.S. at 593 n.17.

If Brandeis were addressing the same subject today, perhaps he would also refer to the performance of federal regulators in connection with the savings and loan and banking crises.

subject to state receivership laws," and to contract with reference to "those laws." *Id.* Thus the Court already has determined that insurance receivership laws are part of a state's regulation of the business of insurance, and that they comprise part of each policyholder's contract. For this reason, Petitioners' attempt to carve state receivership priorities out of the seamless web of insurance regulation ignores the interconnections between those provisions and other state insurance regulations.

Petitioners apparently wish this Court to endorse an interpretation of FPS that would substantially weaken the powers of the states to perform their insurance regulatory and receivership responsibilities. Through McCarran, Congress asked the states to protect policyholders. Petitioners should not now be permitted to wrest from state receivers the resources they need to do their job at the point when claimants most depend upon them—the point of insurer insolvency.

3. Applying FPS to Insurance Receiverships Would Result in an Inefficient Allocation of Scarce Public Resources.

Petitioners submit that a sweeping application of FPS is "fundamental to the success of the national government." Brief for Petitioners at 11. Undoubtedly this was a compelling proposition when FPS originally was adopted in 1797. At that time, the federal government had few sources of tax revenue, and the federal budget was so small that the inability to collect judgments might have materially affected the federal fisc. Today, contrary policy arguments are readily apparent.

As demonstrated above, the cost of Petitioners' proposal would be a substantial diminution in the effectiveness of state insurance regulation. It is tautological that estate

claimants would be deprived of policy benefits to at least the extent of federal claims afforded FPS priority. However, it would be simplistic to suppose that Petitioners' and Respondent's positions are only alternative outcomes in a "zero-sum" game; the result of Petitioners' proposal would be considerably worse because of the chilling effect on receivers described above.

The outcome urged by Petitioners would clearly result in a less efficient allocation of economic resources. Under Petitioners' scenario, a receiver would be obliged to minimize expenditures of estate funds, with the consequent diminution of asset-marshalling activities, and wait for the day when (if ever) the federal government might assert claims. Thus, the federal government might someday be paid on claims it could assert *ex post*, while in the meantime, cautious receivers facing potential personal liability would forego opportunities that otherwise might exist to maximize the collection of estate assets.

A far more efficient allocation of resources would follow from a decision that FPS does not apply to the activities of receivers in maximizing policyholder recoveries. In addition to eliminating the paralyzing effect of potential federal claims having superpriority status, Respondent's view would result in a clear, simple, predictable, *ex ante* system[13] for handling insolvencies—a system aimed primarily at protecting the integrity and reliability of the

[13] The social necessity of predictable legal rules known in advance to all affected parties is clearly recognized by legal and economic scholars. *See, e.g.*, Richard Wagner and James Gwartney, *Public Choice and Constitutional Order, reprinted in Public Choice and Constitutional Economics* (Gwartney and Wagner, eds., 1988).

insurance contract, as contemplated by this Court in *National Securities,* 393 U.S. at 460.[14]

B. UNDER THE SEMINAL *NATIONAL SECURITIES* TEST, REGULATION OF THE "BUSINESS OF INSURANCE" ENCOMPASSES STATE INSURANCE RECEIVERSHIP LAWS, WHOSE PRIORITY PROVISIONS PROTECT POLICY INTEGRITY AND ENFORCEABILITY.

An eminent student of this Court once wrote that "No answer is what the wrong question begets. . . ." Alexander Bickel, *The Least Dangerous Branch* 103 (1962). Petitioners devote considerable effort to demonstrating that the Ohio statute is not regulation of the "business of insurance" for McCarran purposes under the three-pronged test set forth in *Union Labor Life Ins. Co. v. Pireno,* 458 U.S. 119 (1982). Brief for Petitioners at 15-22. In their zeal to force the *Pireno* test upon a case for which it was not intended, Petitioners are addressing the wrong question, and perforce providing no answer to the real issue.

1. The Primary Purpose of McCarran was to Preserve Broad State Powers to Regulate Insurance.

McCarran was a Congressional response to the decision of this Court in *South-Eastern Underwriters.* Both the legislative history of the Act and subsequent commentary

[14] In that respect, the existing state receivership statutes bear some similarities to state corporation laws. The receivership laws in effect amount to statutorily implied terms of the company's policy, affording certain rights to policy claimants, *Chicago Life Ins. Company v. Needles,* 113 U.S at 584, just as state corporation laws provide statutorily implied contract rights to creditors and shareholders of corporations. Frank Easterbrook and Daniel Fischel, *The Economic Structure of Corporate Law* 5-6, 14 (1991).

by the courts and legal scholars reveal that the Act had two primary purposes, both of which are readily apparent from its text.[15]

Because the FPS is an Act of Congress that does not specifically relate to the business of insurance, it cannot ". . . invalidate, impair, or supersede . . ." the Ohio statute. Thus, the obvious and ultimate issue is whether the Ohio statute and its priority provisions regulate the "business of insurance" under the primary thrust of McCarran.

Even before McCarran became effective, this Court held that states retained the power to enforce their insurance regulatory statutes after *South-Eastern Underwriters. Robertson v. California,* 328 U.S. 440 (1946). That the regulatory powers of the states were effectively preserved by McCarran was established peradventure in a better-known decision rendered the same day as *Robertson, Pru-*

[15] *See generally* Weller *supra;* Howard, *supra* note 6.

McCarran provides in part:

§ 1011. Declaration of policy

Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

§ 1012. Regulation by state law; Federal law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948

(a) **State regulation**

The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) **Federal regulation**

No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance * * * unless such Act specifically relates to the business of insurance.

dential Ins. Co. v. Benjamin, 328 U.S. 408 (1946). In the first construction of McCarran essayed by this Court, Justice Rutledge (writing for a unanimous Court) addressed the Congressional intent that gave rise to the Act:

> Obviously Congress' purpose was broadly to give support to the existing and future state systems for regulating and taxing the business of insurance. This was done in two ways. One was by removing obstructions which might be thought to flow from its own power, whether dormant or exercised, except as otherwise expressly provided in the Act itself or in future legislation. [footnote omitted] The other was by declaring expressly and affirmatively that continued state regulation and taxation of this business is in the public interest and that the business and all who engage in it "shall be subject to" the laws of the several states in these respects.

Id. at 430-31.

He continued, exploring the significance of Congress' knowledge of state insurance laws at the time it enacted McCarran:

> (I)n taking this action Congress must have had full knowledge of the nation-wide existence of state systems of regulation and taxation; of the fact that they differ greatly in the scope and character of the regulations imposed and of the taxes exacted; and of the further fact that many, if not all, include features which, to some extent, have not been applied generally to other interstate business. Congress could not have been unacquainted with these facts and its purpose was evidently to throw the whole weight of its power behind the state systems, notwithstanding these variations. *Id.* at 430.[16]

[16] Presumably Congress also was aware of the existence of FPS and of what was then Section 22 of the Bankruptcy Act of 1898, 11 U.S.C. § 22 (repealed 1978), which made domestic insurance companies ineligible for federal bankruptcy.

Thus, this Court immediately recognized the broad "preemptive" effect of state regulation of the business of insurance intended by Congress under McCarran. What remained was to ascribe a meaning to the "business of insurance."

2. This Court Correctly Construed the "Business of Insurance" For the Primary Purpose of McCarran in the *National Securities* Decision.

The most enduring effort by this Court to define the "business of insurance" under McCarran was undertaken in *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969). Unlike later cases of this Court construing the "business of insurance" (*e.g., Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982); *Group Life & Health Ins. Co. v. Royal Drug Co.*, 441 U.S. 917 (1979)), *National Securities* interpreted the "business of insurance" in the context of the primary purpose of McCarran—preserving the role of the states as regulators of the business of insurance. In distinction, *Pireno* and *Royal Drug* involved the Act's secondary purpose of delineating the applicability of federal antitrust laws.

In *National Securities*, this Court upheld the Petitioner SEC's contention that the anti-fraud provisions of the federal securities laws applied in the context of the merger of two insurance companies. Arizona insurance laws required prior approval of the merger by the Arizona Director of Insurance. Respondents argued that the state law would have been "superseded" by application of the federal securities laws. The threshold question for the Court was whether the state law was a "law enacted . . . for the purpose of regulating the business of insurance" under McCarran. 393 U.S. at 457. The Court held that the state law did not regulate the business of insurance, but rather

addressed the relationship between the involved corporations and their stockholders. *Id.* at 460. Consequently, the federal securities laws applied, notwithstanding the "reverse-preemption" rule of McCarran.

Writing for a divided Court, Justice Marshall carefully considered the question of what was intended to have been protected by McCarran: "The statute did not purport to make the States supreme in regulating all the activities of insurance *companies*; its language refers not to the persons or companies who are subject to state regulation, but to laws 'regulating the *business* of insurance.'" 393 U.S. at 459 (emphasis in original). Examples of regulating the "business of insurance" included the fixing of rates, as upheld in *South-Eastern Underwriters*; the sales and promotion of policies, under *FTC v. National Casualty Co.*, 357 U.S. 560 (1958); and the licensing of companies and agents, as in *Robertson*. As Justice Marshall explained:

> Congress was concerned with the type of state regulation that centers around the contract of insurance, the transaction which *Paul v. Virginia* held was not "commerce." *The relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement—these were the core of the "business of insurance."* Undoubtedly, other activities of insurance companies relate so closely to their status as reliable insurers that they too must be placed in the same class. But *whatever the exact scope of the statutory term, it is clear where the focus was—it was on the relationship between the insurance company and the policyholder. Statutes aimed at protecting or regulating this relationship, directly or indirectly are laws regulating the "business of insurance."*

393 U.S. at 460 (emphasis added).

3. Under *National Securities*, Ohio's Priority Statute Regulates the "Business of Insurance".

The Receiver submits that the issue here is easily resolved in Respondent's favor by reference to this Court's description of the "core" and "focus" of McCarran in *National Securities*. Under that description, it is difficult to view the Ohio statute as anything other than a law regulating the business of insurance.

In *National Securities*, the Court referred to three different categories of activities that were within the "business of insurance"—"core" matters; matters within the "focus" of the statutory term, although not necessarily "core" activities; and "other activities" of insurance companies sufficiently related to their status as reliable insurers that they must be classified as part of the "business of insurance." 393 U.S. at 460. The Court described "core" matters as "the relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement." *Id.* The "focus" of the term is "the relationship between the insurance company and the policyholder." *Id.* As Justice Marshall wrote, "(s)tatutes aimed at protecting or regulating this relationship, directly or indirectly are laws regulating the 'business of insurance.'" *Id.* The Court did not specifically define "other activities," but indicated that they must relate significantly to the status of a company as a reliable insurer. *Id.*

Under the *National Securities* "core" concept, the Ohio priority statute regulates the relationship between the insurer and insured, and deals directly with the reliability and enforcement of policies issued by the company in re-

ceivership.[17] The overriding goal of the state's regulatory system—the "seamless web" referred to above—is to protect the policyholder's expectation of coverage. The priority provisions, part of that system, are directed at achieving the goal of protecting policyholders. The Ohio legislature effectively has told the policyholder of an Ohio insurer that, even if the insurer is liquidated, his policy nonetheless may be reliable and enforceable because of the statutory priority that policyholders have to the assets of the issuing company.[18]

Similarly, the Ohio priority statute falls within the "focus" of McCarran. The only conceivable purpose and effect of the statutory priority for policyholders is to protect directly the prospect that the policyholder will be

[17] Of course, "interpretation" of the same policies is also implicated under a closely related Ohio statutory provision. The Liquidator must evaluate the merits and amounts of claims under policies issued by the company before making distributions according to the statutory priorities. Ohio Rev. Code Ann. §3903.43 (Anderson 1989).

[18] In two Circuit Court cases involving FPS, the courts have been unable to recognize the focus on policy reliability and enforcement reflected in state liquidation priority provisions. *Idaho ex rel. Howard v. United States*, 858 F.2d 445 (9th Cir. 1988), *cert. denied*, 490 U.S. 1065 (1989); *Gordon v. United States Dep't of the Treasury*, 668 F. Supp. 483 (D. Md. 1987), 846 F. 2d 272 (4th Cir. 1988), *cert. denied*, 488 U.S. 954 (1988). Perhaps this result followed an unnecessary effort by the courts to force the facts of the cases into the matrix prescribed for antitrust cases under *Pireno*.

The Receiver suggests that these courts were further confused by their tacit assumptions that the priority statutes at issue had no significance until *after* a company was in liquidation. In fact, the priority provisions, comparable to the mandatory provisions of state corporation law, provide implicit terms of insurance contracts that inure to the benefit of a policyholder from the day his policy is issued. *See Chicago Life Ins. Company v. Needles*, 113 U.S. at 584; *Cf.* Easterbrook and Fischel, *supra note* 14, at 5-6, 14.

paid, from assets of the company, claims covered by the policy that the company issued to him.

This case differs in one significant respect from both *National Securities* and the two deceptively similar antitrust decisions of this Court, *Pireno* and *Royal Drug*. This is not a "business of insur*ers*" case. In each of those three cases, an active insurance company unsuccessfully invoked McCarran to avoid the effect of federal law for a corporate advantage divorced from its relationship with policyholders.[19] The Ohio priority statute now before this Court is a matter of virtual indifference to the operators of active companies to which it might someday apply.[20]

In sum, the Ohio priority statute directly benefits policyholders rather than insurers. The distribution priority it affords over other estate claimants presumably reflects the Ohio legislature's judgment that policyholders are different from other creditors of an insurance company and should receive special treatment.[21]

[19] In *National Securities*, companies subject to state insurance regulation sought to assert the Arizona insurance law as a shield against merger disclosure requirements of the federal securities laws; in *Royal Drug*, defendants in a civil antitrust case tried to show that Texas insurance laws rendered federal law inapplicable to contracts entered into with pharmacies participating in a discount arrangement; similarly, in *Pireno*, civil antitrust defendants claimed that New York insurance laws rendered the voluntary use by a health insurer of a professional review panel beyond the reach of the federal antitrust laws.

[20] The Ohio law provides for distribution of remaining assets to shareholders after all higher-priority claims have been paid. *See* Ohio Rev. Code Ann. §3903.42(H) (Anderson 1989). Needless to say, such distributions seldom are made. *See* Howard, *supra note* 6, at 13.

[21] *See* Kimball, *supra*, at 33.

4. Application of the *National Securities* Holding in this Case Gives Effect to the Primary Goals of McCarran.

For several reasons, the Receiver urges this Court to apply the "business of insurance" test set forth in *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969), notwithstanding the Court's later rulings in *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982), and *Group Life & Health Ins. Co. v. Royal Drug Co.*, 441 U.S. 917 (1979).

First, as noted above, McCarran had two purposes, addressed in distinct parts of the Act. The first purpose was broadly to preserve the authority of the states to tax and regulate the business of insurance, except to the extent of federal laws expressly intended to affect that business. *Prudential Insurance Co. v. Benjamin*, 328 U.S. at 430-31. The ancillary purpose of the Act was to clarify the applicability of the federal antitrust laws to the insurance business.[22] *National Securities* interpreted "business of insurance" in the context of McCarran's primary purpose; *Pireno* and *Royal Drug* interpreted the same words for the narrow, ancillary purpose of determining federal antitrust jurisdiction. The instant case involves McCarran's principal purpose—defining the boundaries of the insurance regulatory powers of the State of Ohio.

More significantly, the *Pireno* and *Royal Drug* standards were crafted to do a narrow, specific job. They seem crabbed, mechanical, and talismanic when offered for the purpose of defining the scope of McCarran's broad grant of authority to the states. As Justice Rutledge wrote in *Prudential*, the purpose of Congress in enacting McCarran ". . . was evidently to throw the whole weight of its power behind the state systems." 328 U.S. at 430. The broad, flexible standards set forth in *National*

[22] Howard, *supra* note 6 at 79.

Securities best give effect to that intent, at least in cases outside of the antitrust area.

The Receiver recognizes that courts eschew ascribing different meanings to similar or identical terms within a statute. However, this "rule of consistency" is merely a principle of statutory construction, not a substantive rule of law. *See* Howard, *supra note* 6, at 83; *see also Pireno v. New York State Chiropractic Assoc.*, 650 F.2d 387, 394 n.12 (2nd Cir. 1981), *rev'd sub nom. Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982). To the extent this Court wishes to preserve for antitrust purposes the analysis reflected in *Pireno* and *Royal Drug*, the Court should consider the proposal of commentators, noted in the lower federal courts, that the "business of insurance" be interpreted according to different standards, depending upon the specific provision of McCarran at issue.[23] Here, the primary purpose of McCarran is involved, and an interpretation of the "business of insurance" consistent with that broad Congressional purpose should be employed.

CONCLUSION

Long before Congress enacted McCarran, states administered receiverships of troubled insurers. By adopting McCarran, Congress reaffirmed its long-standing conclusion that the states are responsible for the regulation of insurance companies. The Ohio statute in this case mere-

[23] *See, e.g.*, Howard, *supra note* 6 at 83; Note, *The Definition of 'Business of Insurance' Under the McCarran-Ferguson Act After Royal Drug*, 80 Colum.L.Rev. 1475, 1479-81 (1980). *See also Pireno v. New York State Chiropractic Assoc.*, 650 F.2d 387, 394 n.12 (2nd Cir. 1981); *rev'd sub nom. Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982); *Lyons v. United States*, No. 4-91-10209; 1992 U.S. Dist. LEXIS 11714 at *5 n.3 (S.D. Iowa July 2, 1992).

ly establishes priorities for distribution of the assets of insolvent companies within the seamless web of Ohio's regulatory framework. Effective state regulation of operating companies is inextricably intertwined with state laws regarding insurance receivership. Petitioners' attempt to impose the restrictions of FPS on state receivers would have the practical consequence of seriously impairing receivers in the performance of their statutory obligations. The economic benefit to the federal government of the revenues generated by such a result would be far outweighed by the negative consequences to the intended beneficiaries of receivership laws (primarily policy owners and beneficiaries).

In its *National Securities* decision, this Court established a standard defining the "business of insurance" for purposes of McCarran that should be applied in this case. Under that standard, state regulation affecting the relationship between the insurer and insured, and the enforcement and reliability of insurance policies, was held to be the "core" of the business of insurance. Ohio's priority statute is designed specifically for the purpose of ensuring the enforcement and reliability of a troubled insurer's obligations under its policies.

For the foregoing reasons, the decision of the Sixth Circuit should be affirmed.

Respectfully submitted,

PETER G. GALLANIS
Counsel of Record
Chief General Counsel to the Director, as Receiver
Office of the Special Deputy Receiver
222 Merchandise Mart Plaza
Chicago, Illinois 60654
(312) 836-9500

Counsel for Amicus Curiae